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Nos. 96-954 and 96-1230

IN THE
Supreme Court of the United States
OCTOBER TERM, 1996

AMOCO PRODUCTION COMPANY, *et al.*,
Petitioners,
v.
PUBLIC SERVICE COMPANY OF COLORADO, *et al.*,
Respondents.

WILLIAMS NATURAL GAS COMPANY,
Cross-Petitioner,
v.
AMOCO PRODUCTION COMPANY, ANADARKO PETROLEUM CORPORATION, MOBIL OIL CORPORATION, OXY USA, INC.
AND
UNION PACIFIC RESOURCES COMPANY,
Cross-Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF OF *AMICI CURIAE* THE INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA AND THE KANSAS INDEPENDENT OIL AND GAS ASSOCIATION IN SUPPORT OF PETITIONERS

20 pp

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QUESTION PRESENTED

Whether a regulated entity is entitled to rely on a final agency decision unless and until that decision is overturned by the agency or a court of competent jurisdiction in a later case, or an act of Congress.

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STATEMENT OF INTEREST OF *AMICI CURIAE*

The Independent Petroleum Association of America ("IPAA") is a national trade association representing approximately 5,500 individuals and independent oil and natural gas producing companies involved in the exploration, development, and production of crude oil and natural gas in the United States. The membership of IPAA includes natural gas producers in Kansas. IPAA participates in legislative, federal regulatory and litigation matters on behalf of its members.

The Kansas Independent Oil and Gas Association ("KIOGA"), an organization of over 850 members, represents independent oil and gas producers and operators, supporting petroleum industry professionals and service and supply companies who serve the industry throughout Kansas. KIOGA is vitally concerned with matters which impact the oil and gas industry, which is a fundamental component in the economy of Kansas.

The decision by the United States Court of Appeals for the District of Columbia Circuit ("D.C. Circuit") in the proceedings below will have a significant adverse impact on producers in Kansas. The practical economic impact of this decision will be felt by many IPAA and KIOGA members.

IPAA's and KIOGA's familiarity with the natural gas industry in the State of Kansas and with the adverse economic consequences that the decision of the D.C. Circuit will have on producers and production will benefit the Court in considering this case. IPAA and KIOGA therefore submit this brief of *amici curiae* in support of petitioners, Amoco Production Company, *et al.*

This brief is filed with the consent of the parties. Consent letters have been filed with the Clerk.

STATEMENT OF THE CASE

This case arises from a 1996 decision of the D.C. Circuit modifying a Federal Energy Regulatory Commission ("FERC" or "Commission") order imposing liability on gas producers for *ad valorem* taxes charged to customers. *Public Serv. Co. of Colo. v. FERC*, 91 F.3d 1478 (D.C. Cir. 1996). FERC initially ordered refunds retroactive to 1988. *Colo. Interstate Gas Co.*, 65 F.E.R.C. ¶ 61,292 (1993). The D.C. Circuit's decision increased the liability of producers by ordering refunds for natural gas production retroactive to October 1983. *Public Serv. Co. of Colo.*, 91 F.3d at 1490. While the Court affirmed the FERC holding that the Kansas *ad valorem* tax is not subject to recovery from purchasers under Section 110 of the Natural Gas Policy Act of 1978 ("NGPA"), 15 U.S.C. §§ 3301 - 3432 (1978), the Court refused to defer to the carefully reasoned remedy adopted by the Commission.[1] The estimated impact of this decision on Kansas Gas Producers is almost one-half billion dollars.

The facts are set forth fully in the Petition and will not be repeated here, except to note that, the history of this case

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[1] The D.C. Circuit imposed liability for refunds beginning in October 1983 because that was "the date when all interested parties were given notice in the Federal Register that the recoverability of the Kansas tax under Section 110 of the NGPA was at issue...". *Public Serv. Co. of Colo.*, 91 F.3d at 1490. This reasoning clearly ignores the prior regulatory treatment of the Kansas *ad valorem* tax, upon which producers had relied since 1974.

extends back to 1974 when the Federal Power Commission ("FPC"), predecessor to the FERC, initially promulgated national maximum rates under the Natural Gas Act ("NGA"), 15 U.S.C. § 717 (1978), for producer sales.

In 1974, the FPC provided that, under the NGA, the maximum applicable rate "shall be adjusted upward for all State or Federal production, severance, or similar taxes." Opinion No. 699, 51 F.P.C. 2212, 2301 (1974). In that same year, at the request of the Corporation Commission of the State of Kansas ("KCC"), the FPC issued a subsequent opinion, clarifying Opinion No. 699, and providing further guidance allowing producers making jurisdictional sales in Kansas to adjust upward the national rate prescribed in Opinion No. 699 by the amount of the Kansas *ad valorem* tax. The FPC held that the Kansas *ad valorem* tax was a severance tax because "the bulk of the Kansas *ad valorem* tax is based upon production factors, and, as such, is in fact, a severance or production tax merely bearing the title '*ad valorem* tax.'" Opinion No. 699-D, 52 F.P.C. 915 (1974).[2] The FPC decision was a final ruling by a federal agency.

SUMMARY OF ARGUMENT

Natural gas production in Kansas is important not only to producers but to the economy of the state. Natural gas and/or oil is produced in 89 of the 105 counties in Kansas.

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[2] The FPC issued a supplemental order to Opinion No. 699-D articulating the proper procedure for collecting the Kansas *ad valorem* tax. *See* Order Supplementing Opinion No. 699-D, 52 F.P.C. 1326 (1974). This supplemental order further evidences the FPC's intent to treat the Kansas tax as an "upward adjustment" and, accordingly, recoverable as part of the national rate established in Opinion No. 699. *See id.*

Independent Petroleum Association of America, *Petroleum Independent*, Sept.-Oct. 1996, at 44. Much of the gas production comes from stripper wells, which are particularly vulnerable to the economic effects of the D.C. Circuit's decision. In 1995, the average number of employees engaged in the oil and gas business in Kansas was 24,002. *Id.* at 45. That does not include the land owners who receive royalty payments from the sale of oil and gas. The entire industry, including land owners, will be fiscally disadvantaged if the substantial additional refunds ordered retroactively by the D.C. Circuit are allowed to stand.

Producers and operators have historically relied on FERC for guidance and have followed, since Opinion No. 699 was issued in 1974, the specific rulings of the FPC and FERC as well as the legislative history of the NGPA allowing for recovery of severance taxes. When the Commission made the determination that the Kansas *ad valorem* tax would no longer be treated as a severance tax under Section 110 of the NGPA, the Commission set a reasonable retroactive date of recovery for it. Entities subject to regulation by federal agencies, as in this case, must be entitled to rely upon the validity of final agency determinations. *See* Administrative Procedure Act ("APA") 5 U.S.C. § 557(b) (1996). Kansas producers did so. It is patently unfair to permit, as the D.C. Circuit did in the case at bar, final agency orders, which are challenged many years later, to undercut all prior regulation. The 1974 FPC determination to allow recovery of the Kansas *ad valorem* tax as a severance tax under Section 110 of the NGPA remained in effect until overturned by FERC on remand from the D.C. Circuit in 1988. A decision that notice and refunds attach whenever a pleading is filed with an administrative agency means no one can ever rely upon final agency orders.

Additionally, to suggest, as Williams Natural Gas does in its Cross-Petition for Writ of Certiorari, that refunds should be retroactive to 1978 is untenable. To order refunds retroactive to 1978 would be a punitive measure imposed upon producers who were acting in accordance with a final FERC determination on how the Kansas *ad valorem* tax should be treated.

FERC understood that its order would severely impact natural gas producers, and sought to appropriately balance the liability for the *ad valorem* taxes between the producers and their customers. By contrast, the additional $500 million burden that the D.C. Circuit has imposed on producers fails to balance the equities involved. The practical impact of this burden will affect the entire industry and, if not reversed, could lead to the abandonment of certain wells, particularly stripper wells, resulting in loss of a precious natural resource. The D.C. Circuit's decision further demonstrates that decisions such as this are properly made by the agency charged with responsibility for overseeing the statute and regulating the industry -- the agency which understands the consequences to the industry and the economy when imposing retroactive liability.

ARGUMENT

I. The D.C. Circuit Decision Will Have a Significant Adverse Impact on Natural Gas Producers and the State of Kansas.

Natural gas production in Kansas is unique. There were 14,878 natural gas wells producing in 1995 in the state but over 19% (2,830) of the wells were stripper wells as defined by the NGPA. *See* 15 U.S.C. § 3301 (1978). Stripper wells are a

special category recognized by Congress in the NGPA as economically marginal wells which required separate legislative consideration in order to avoid premature abandonment and the loss of otherwise recoverable natural gas reserves.[3] According to data collected by the KCC, the 2,830 stripper wells produced a total of 36.6 Bcf of gas in 1995. Independent Petroleum Association of America, *Petroleum Independent*, Sept.-Oct. 1996, at 44. While these wells constituted significant production in total, the wells only produced an average of 35.4 Mcf per day. *Id.* The average price of gas in Kansas at the wellhead was only $1.37 per Mcf; the average stripper well generated a meager $48.50 per day in gross revenue. *Id.* at 45. That amount is reduced by royalty payments (generally 12.5%), county and state taxes (14%), and operating expenses.

Stripper wells accounted for more than $10 billion in U.S. economic activity and more than 28,000 jobs nationwide in 1995. Interstate Oil and Gas Compact Commission, *Marginal Oil and Gas: Fuel for Economic Growth* (1996). These wells are a vital source of domestic production, accounting for approximately 14 percent of U.S. oil production and 4.7 percent of U.S. gas production. *Id.*[4] While stripper wells may be considered marginal, they are not disposable. The

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[3] *See* H.R. CONF REP. No. 1752, 95th CONG., 2d SESS. 88 (1978); STAFF OF HOUSE COMM. ON INTERSTATE & FOREIGN COMMERCE & STAFF OF SENATE COMM. ON ENERGY & NATURAL RESOURCES, 95th CONG., 2d SESS., NATURAL GAS PRICING AGREEMENT ADOPTED BY CONFERREES ON H.R. 5289 (Comm. Print 1978).

[4] Stripper oil and gas well production generated $1.37 billion in employment earnings and $3120 million in severance taxes for the country last year. *Id.*

United States is the only country with significant production from stripper wells. The decision of the D.C. Circuit however, will encourage the premature abandonment of stripper wells, because production from such wells will no longer be economically viable. Once stripper wells are plugged it is not economically feasible to reopen them and their resource is gone forever.

Conservation and prevention of waste are legitimate issues of concern for producers in Kansas. An additional five year retroactive refund neglects these issues and fails to account for the realistic impact of such neglect on those producers, and, ultimately, the orderly use of a limited natural resource. This added liability will impose sufficient hardship on producers such that the production of natural gas will be a fiscal impossibility, forcing many producers to either shut down wells and/or declare bankruptcy, leaving significant amounts of natural gas untapped. This waste is precisely what the State of Kansas, and, ultimately the Commission, were trying to avoid by allowing the Kansas *ad valorem* tax to be recovered as a severance tax. Appropriately, the FERC decision crafted a remedy reflecting the competing considerations and burdens; the impact of a remedy must be carefully considered as the Commission did in exercising its extensive knowledge of the industry, the economics of the industry and regulatory history. The D.C. Circuit failed to take into consideration the need for conservation and protection against waste, both which could be impacted from premature abandonment of stripper wells.

Natural gas producers operate in more than one state. To the extent the additional refund obligation imposed by the

D.C. Circuit causes extreme financial hardship to a producer, the producer's drilling and production activities in all states will be jeopardized.

This case raises substantial economic impact concerns. Those concerns, while most acute in Kansas, extend beyond state borders. The magnitude of the impact warrants review of the D.C. Circuit decision by this Court.

II. Final Agency Decisions Must Not be Rendered Meaningless by Later Court Determinations.

In 1974, the FPC ruled that the Kansas *ad valorem* tax could properly be recovered by natural gas producers from their purchasers *in addition to* the purchase price. It was an appropriate add-on. The FPC order was not challenged. Neither were subsequent FPC and FERC orders which affirmed that determination. The clear regulatory policy was to allow recovery of the Kansas *ad valorem* tax by producers from gas purchasers.

In 1978, Congress codified the FPC's prior regulatory treatment of state tax costs. Under Section 110 of the NGPA, the price charged for the first sale of natural gas could exceed the otherwise applicable maximum lawful price to the extent necessary to recover any "State severance taxes attributable to the production of ... natural gas borne by the seller." 15 U.S.C. § 3320(c) (1988). FERC incorporated the FPC's pre-NGPA regulatory scheme, including the pre-NGPA ruling on the Kansas *ad valorem* tax, into its post-NGPA analysis. Subsequently, FERC followed the pre-NGPA Kansas tax decision in authorizing producers to recover costs of other state taxes under Section 110 of the NGPA.

FERC affirmed its earlier treatment of the Kansas *ad valorem* tax in 1979. *Independent Oil & Gas Assoc. of W. Va.*, 7 F.E.R.C. ¶ 61,094 (1979). The Commission held a similar West Virginia property tax (*ad valorem* tax) was a "production, severance, or similar tax" within the meaning of Opinion Nos. 699-H, 52 F.P.C. 1604 (1974), and 770-A, 56 F.P.C. 2698 (1976).[5] In 1982, the Commission reiterated its position that taxes related to production shall be treated as severance taxes when it held that a West Virginia service tax may be collected by the producer and such collection will not be considered to exceed the applicable maximum lawful price. *Trio Petroleum Corp.*, 18 F.E.R.C. ¶ 61,203 (1982). In reaching this position, FERC noted its conclusion was supported by language in the Joint Explanatory Statement of the Committee of Conference of the NGPA. The term "State severance tax" is intended to be construed broadly. *Id.* (*citing* H.R. REP. No. 1752, 95th Cong., 2d Sess. 91 (1978)).

Nine years after the initial agency decision permitting recovery of the *ad valorem* tax from gas purchasers, Northern Natural Gas Company ("NNGC") petitioned FERC to reconsider the FPC's 1974 Kansas tax ruling. FERC denied NNGC's request for rehearing on several grounds and affirmed

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[5] Commission Opinion Nos. 699-H and 770-A established the rate of general applicability under the NGA. These opinions include a tax adjustment provision which is codified in Section 2.56a(b) of the Commission's General Policy and Interpretation. *Independent Oil & Gas Assoc. of W. Va.*, 7 F.E.R.C. ¶ 61,094 (1979). The Commission also cited Opinion 699-D, 52 F.P.C. 915 (1974), for the proposition that "the Kansas *ad valorem* tax was based upon production factors and was therefore a proper upward adjustment to the national rate, and ordered that any state *ad valorem* tax which is based upon production factors will in the future be considered a 'similar tax.' The ruling there also applies to Opinion No. 770-A." *Id.*

its consistent historical treatment of the Kansas tax. *See Sun Exploration & Prod. Co.*, 36 F.E.R.C. ¶ 61,093 (1986), *reh'g denied sub nom. Northern Natural Gas Co.*, 38 F.E.R.C. ¶ 61,062 (1987). Upon review of that decision, the D.C. Circuit remanded the matter to FERC for further clarification of its position that the Kansas tax qualified as a severance tax under Section 110 of the NGPA. *See Colorado Interstate Gas Co. v. FERC*, 850 F.2d 769, 771 (D.C. Cir. 1988). Subsequently, in 1993, FERC reversed its prior decisions spanning the previous nineteen years, and held for the first time that the Kansas tax did not qualify as a severance tax under Section 110 of the NGPA.[6]

In reaching this conclusion the Commission was careful to review provisions for adopting a proper remedy. In exercising its discretion, the Commission employed the resources available to it as the agency charged with making national policy determinations of this nature. FERC, in balancing all competing interests including the federal court administrative retroactivity standards, concluded that refunds should be offered retroactive to 1988, the year the industry was first put on notice that taxes such as the Kansas *ad valorem* tax would no longer be treated as severance taxes under the NGPA Section 110.[7] Subsequently, on petition for review, the D.C.

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[6] Colorado Interstate Gas Co., 65 F.E.R.C. ¶ 61,292 (1993). Although this decision was challenged in the proceedings below, producers are not contesting the issue in this court. *See* Petition for Writ of Certiorari at 5 n.3. *Amici's* purpose in reviewing this issue is to contrast the years of reliance on FERC's treatment of the Kansas tax with the D.C. Circuit's arbitrary decision to order refunds retroactive to 1983.

[7] *Colorado Interstate Gas Co.*, 65 F.E.R.C. at 62,372 (stating "Upon review of the relevant court standards of administrative retroactivity we conclude that [the Commission's] ruling should be applied retroactively

Circuit arbitrarily imposed five more years of refund requirements beyond the refunds ordered by FERC, based on notice published in the Federal Register.[8] With interest, it is estimated that the total additional refund obligation approaches $500 million. The decision reflects an important lack of understanding on behalf of the D.C. Circuit as to the genuine impact of its decision, an impact that was understood and properly addressed by the Commission, and, more importantly, violates the APA 5 U.S.C. § 551-559 (1996) by failing to defer to agency discretion.

Congress recognized the need for regulatory certainty in the energy industry by permitting changes in rates resulting from complaint proceedings under Section 5 of the NGA, 15 U.S.C. § 717(d) (1996), *prospectively only from the date of a final Commission order or court order*. The interstate pipeline request to rescind recovery of the *ad valorem* tax was a complaint similar to an NGA Section 5 complaint. FERC denied the complaint in 1987. However, the D.C. Circuit ruled that the mere filing of the complaint triggered refund liability. The decision eliminates the fundamental concepts of fairness and regulatory certainty.

The very nature of regulation requires that parties subject to that regulation be allowed to rely on final decisions

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to the date of the court's decision in [*Colorado Interstate Gas*], June 28, 1988.")

[8] *See Public Service Co. of Colo.*, 91 F.3d at 1490. ("...we hold that the producers liability for refunds extends back to October 1983, the date when all interested parties were given notice in the Federal Register that the recoverability of the Kansas tax under § 100 of the NGPA was at issue...").

by the regulatory body which have not been appealed or which have been confirmed on appeal. The D.C. Circuit decision makes all such regulatory decisions meaningless if anyone later raises an issue in a regulatory proceeding, *even if the regulatory body affirms its prior decision*. The D.C. Circuit decision calls into question all final decisions by regulatory agencies. Reliance on agency decisions is fundamentally important to any industry subject to regulation. To allow the D.C. Circuit to arrogate this certainty through arbitrary decisions, such as this retroactive refund, undermines the purpose of federal regulation and, accordingly, warrants review.

CONCLUSION

For the reasons stated above, IPAA and KIOGA respectfully request the Court grant the Petition for Writ of Certiorari and review and reverse the decision below.

Respectfully submitted,

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